S T A T E O F M I C H I G A N

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of Wisconsin Electric Power Company's power supply cost recovery reconciliation proceeding for the 12-month period ended December 31, 2009	)))))	Case No. U-15664-R

NOTICE OF PROPOSAL FOR DECISION

The attached Proposal for Decision is being issued and served on all parties of record in the above matter on July 8, 2011.

Exceptions, if any, must be filed with the Michigan Public Service Commission, P.O. Box 30221, 6545 Mercantile Way, Lansing, Michigan 48909, and served on all other parties of record on or before July 29, 2011 or within such further period as may be authorized for filing exceptions. If exceptions are filed, replies thereto may be filed on or before August 12, 2011. **The Commission has selected this case for participation in its Paperless Electronic Filings Program. No paper documents will be required to be filed in this case.**

At the expiration of the period for filing exceptions, an Order of the Commission will be issued in conformity with the attached Proposal for Decision and will become effective unless exceptions are filed seasonably or unless the Proposal for Decision is reviewed by action of the Commission. To be seasonably filed, exceptions must reach the Commission on or before the date they are due.

MICHIGAN ADMINISTRATIVE HEARING SYSTEM
For the Michigan Public Service Commission

Mark Eyster

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Mark D. Eyster
Administrative Law Judge

July 8, 2011
Lansing, Michigan

PUBLIC VERSION

S T A T E O F M I C H I G A N

MICHIGAN ADMINISTRATIVE HEARING SYSTEM

FOR THE MICHIGAN PUBLIC SERVICE COMMISSION

* * * * *

In the matter of the application of Wisconsin Electric Power Company's power supply cost recovery reconciliation proceeding for the 12-month period ended December 31, 2009	)))))	Case No. U-15664-R

PROPOSAL FOR DECISION

PROCEDURAL HISTORY

On March 31, 2010, the Wisconsin Electric Power Company (WEPCo) filed its application requesting Michigan Public Service Commission (Commission) approval of WEPCo's reconciliation of power supply costs and revenues for the 12-month period of January 2009 through December 2009. On May 27, 2010, a pre-hearing conference was held before Administrative Law Judge, Mark D. Eyster. Counsel appeared on behalf of WEPCo, the Michigan Public Service Commission staff (Staff), Citizens Against Rate Excess (CARE), and Tilden Mining Company L.C. and Empire Iron Mining Partnership (Mines). At the pre-hearing conference, intervenor status was granted to CARE and the Mines and a schedule was adopted. An evidentiary hearing was conducted on December 16, 2010, at which, the pre-filed testimony of the witnesses was bound into the record and the exhibits were admitted into evidence. None of the witnesses were tested under cross-examination. Briefs were filed on

January 18, 2011, and reply briefs were filed on February 1, 2011. The record consists of testimony contained in the 270 page transcript and 55 exhibits.

FINDINGS OF FACT

Introduction

WEPCo presented the testimony of Thomas P. Lordon, a Senior Project Analyst in WEPCo's Regulatory Affairs and Policy Department and Jeff Knitter, the Special Projects Manager in WEPCo's Wholesale Energy and Fuels Department. Mr. Lordon presented direct testimony to "describe the operation of the Company's generating units and the obtaining of fuel and purchased power during 2009"; "to compare projected power supply costs for the 2009 PSCR Plan year with the actual costs experienced that year"; regarding "the reconciliation of 2009 calendar year power supply revenues recorded, whether recovered in base rates or in PSCR factors, with the booked cost of power supply; and [regarding] the true-up of the 2008 power supply reconciliation amounts." Tr 2, p 59. In rebuttal, he provided testimony to address proposed adjustments to WEPCo's renewable and surplus energy costs. Mr. Lordon sponsored Exhibit A-1. Mr. Kitter presented rebuttal testimony "to: (i) address . . . testimony . . . that Wisconsin Electric unreasonably and imprudently deviated from its approved [Risk Management Plan (RMP)]; (ii) demonstrate that Wisconsin Electric's hedging costs were reasonably and prudently incurred; (iii) address . . . testimony . . . that several of Wisconsin Electric's hedging transactions violated its RMP; (iv) respond to . . . testimony challenging the recovery of coal

transportation take-or-pay charges; and (v) address . . . testimony regarding the recovery of replacement power costs during outages at Oak Creek". Tr 2, p 105. Mr. Knitter sponsored confidential exhibits A-2 and A-3.

The Mines presented the direct and surrebuttal testimony of Michael P. Gorman, a public utility regulatory consultant and a Managing Principal of Brubaker & Associates, Inc. Mr. Gorman provided testimony addressing WEPCo's Wisconsin related renewable portfolio standard costs, an outage at WEPCo's Oak Creek power plant, demurrage costs, coal penalty costs, and WEPCo's natural gas purchases. Tr 2, p 136. Additionally, he submitted surrebuttal in response to the rebuttal testimony of WEPCo's witness, Mr. Knitter, and sponsored exhibits MIN-1 through MIN-22.

CARE presented the direct testimony of Dr. Robert Loube, the Vice President and a principal owner of Rolka Loube Salter Associates. Dr. Loube's testimony addressed the demurrage charges, charges for coal not taken, fuel charges associated with purchases of renewable power, and replacement fuel charges associated with power plant outages. Tr 2, p 176. Dr. Loube sponsored exhibits CARE-1 through CARE-10.

In its Application, WEPCo states that the 12-month reconciliation of the power supply costs and revenues for 2009 results in a net under-recovery of $1,572,080[1]. WEPCo adds that its 2008 reconciliation true-up resulted in an under-recovery, including interest during 2009, of $431,108[2]. Thus, WEPCo

[1] In his testimony, WEPCo witness, Mr. Lorden, states that the net under-recovery, as found in Exhibit A-1, Schedule 2, equals $1,613,034. Tr 2, p 77.
[2] In his testimony, WEPCo witness, Mr. Lorden, states that this under-recovery amount, as found in Exhibit A-1, Schedule 5, equals $425,609. Tr 2, p 80-81.

states there is an under-recovery of $2,003,188 to be reconciled. In the supplemental testimony of WEPCo's witness, Mr. Lorden, it is proposed that the Commission incorporate, into this proceeding, a refund of $66,176; the amount remaining in the Point Beach Fund. Tr 2, p 84. After removing this from the under-recovery, WEPCo calculates the under-recovery amount to equal $1,937,012. Tr 2, 86. WEPCo proposes to roll this under-recovery amount into its 2010 PSCR reconciliation case. Tr 2, p 86.

The parties have proposed various disallowances related to demurrages, renewable and surplus energy purchases, charges for coal not taken, outages at WEPCo's Oak Creek plant, and natural gas purchases. Each will be separately addressed, below.

Demurrage

The parties agree that certain demurrage charges should be excluded. As evidenced by Exhibit MIN-13, WEPCo admits that $99,311.20 in demurrage charges should be excluded from PSCR costs. This figure is accepted as fact.

The Mines' witness, Mr. Gorman, calculated that this disallowance reduces Michigan's PSCR costs by $8,252. Tr 2, p 149. In its initial brief, WEPCo presented calculations pegging this number at $11,610. In its reply brief, the Mines pointed out that WEPCo's calculation included a computational error, indicated their preference for WEPCo's formula, and provided a proper calculation that resulted in a figure of $9,417.

Renewable and Surplus Energy Purchases

In 2006, the State of Wisconsin instituted a Wisconsin Renewable Portfolio Standard (RPS) for all Wisconsin electric providers. Tr 2, p 139. Under the RPS, in 2009, WEPCo was required to have "baseline renewable energy generation" equal to 2.27% of its Wisconsin retail sales. Tr 2, p 139. WEPCo meets the RPS with a "combination of renewable purchased power transactions and installed hydro and wind plants." Tr 2, p 139. "Exhibit A-1 (TPL-1), Schedule 1 identifies a purchased power line item titled 'Renewable / Surplus', which contains RPS costs of $17.377 million. This cost is based on RPS supply charges of $85.68/MWh and 202,806 MWh of RPS energy." Tr 2, p 140. Exh A-1, schedule 1.

As explained by Mr. Gorman, at Tr 2, p 141,:

> In 2009, to comply with the WRPS, WEPCo needed 535,126 MWh of renewable energy generation. . . . [T]o satisfy the . . . requirement . . ., WEPCo had 243,750 MWh of Hydro RPS generation (associated costs were included in the 2009 base rates of both Michigan and Wisconsin ratepayers), 293,769 MWh of Wind RPS generation (associated costs were included in the 2009 base rates of both Michigan and Wisconsin ratepayers) and 202,806 MWh of "Renewable / Surplus" purchase power transactions. This totals 740,325 MWh of RPS energy . . . .

In 2009, WEPCo "did not assign . . . the cost of any renewable project directly to Michigan customers to be recovered in 2009 through [Michigan's] Renewable Energy surcharge or any other component of rates." Tr 2, 92. WEPCo's "renewable energy surcharge was not in effect at all during 2009" and "during all of 2009, base rates, the PSCR plan and PSCR factors [were] all based upon the long-standing approach of determining recoverable costs on a

system-wide average basis." Tr 2, p 92. See Case No. U-12615 and Case No. U-13266.

Included in the renewable and surplus energy classification "are different categories and vintages of contracts." Tr 2, p 93-94. As explained by WEPCo's witness, Mr. Lorden, at Tr 2, p 94-97:

> A significant portion of the "Surplus" energy is produced by Customer Owned Generation Systems (COGS) and purchased pursuant to comparable retail tariff requirements in both Wisconsin and Michigan. In Michigan, the Company's COGS tariffs were first approved by the MPSC in its August 27, 1982 Order in Case No. U-6798 approving tariffs implementing mandatory PURPA cogeneration purchase requirements. In Wisconsin, federally mandated purchases of "Surplus" cogeneration and other energy (including some renewables) are made pursuant to comparable approved retail tariff provisions. In Exhibit A of the August 27, 1982 Order Approving Settlement Agreement is the Agreement Section X. on Cost Recovery which states:
>
> > "Payments made by the Companies to qualifying facilities for the purchases of energy and capacity shall be recoverable through the power supply cost recovery clause or other mechanism established by the Commission."
>
> Since 1982, the Company has included purchases pursuant to both Michigan and Wisconsin approved COGS tariffs in its base rates, PSCR plans and PSCR reconciliations. The Michigan tariffs in effect in 2009 continued to require and set the price to be paid for such purchases. Even the tariffs approved in the July 1 Order continue to mandate that the Company make such purchases. . . . The costs of such purchases mandated by federal law were not assigned only to wholesale rates and customers but are allocated to all customers, including Michigan customers, on a system-wide basis.
>
> A second category of . . . purchases . . . is the . . . various contracts for the purchase of renewables, which . . . have been previously included in PSCR plans approved by the Commission. For example, in the 2006 PSCR plan case, Case No. U-14707, Mr. Schumacher testified in support of approval of PSCR costs arising out of various renewable contracts, stating:
>
> > Miscellaneous Renewable Energy Contracts: For 2006, Wisconsin Electric has entered into eighteen (18) renewable energy agreements with fourteen (14)

different suppliers, representing four (4) different sources of renewable energy. The suppliers are Waste Management, Inc. (land fill gas, three agreements totaling 25 MW and ending in 2010, and one agreement for 3.2 MW beginning in 2006 through 2021; Outagamie County, Wisconsin (land fill gas, one agreement for 2.6MW ending in 2006); G.A.S.-Access (landfill gas, two agreements for 5MW beginning in 2006 and ending in 2021); FPL-Badger Windpower, LLC (wind, one agreement for 25.5MW beginning in 2001 and ending in 2011); Ag Environmental Solutions, LLC (agricultural waste, one agreement for 0.75MW beginning in 2001 and ending in 2011); Top of Iowa (wind, one agreement for 40MW of renewable credits beginning in 2001 and ending in 2011); Onyx/Glacier Ridge (landfill, one agreement for 0.24MW of renewable credits beginning in 2005 and ending in 2012); Quantum Dairy (agriculture waste, one agreement for 0.2MW beginning in 2005 and ending in 2015); Eden Renewable (wind, one agreement for 3.3MW beginning in 2006 and ending in 2016); Addison Wind Energy (wind, one agreement for 1.65MW beginning in 2006 and ending in 2016); Cedarburg Hydro (hydro, one agreement for 0.156MW beginning in 2002 and ending in 2007); Rock River Hydro (hydro, one agreement for 0.1MW beginning in 2002 and ending in 2007); N.E.W. Hydro (hydro, one agreement for 0.25MW beginning in 2002 and ending in 2007), and Maple Leaf Duck Farm Inc. (agricultural waste, two year agreement). The contracts with FPL-Badger Windpower, LLC, Ag Environmental Solutions, LLC and Maple Leaf Duck Farm have provisions to extend the term beyond the original contract period. While these contracts reflect a total of approximately 26 MW of installed capacity, wind resources do not provide firm dispatchable capacity, yielding only 7MW which can be relied upon as firm capacity. Each of the renewable energy sources that is in operation, with the exception of the three hydro facilities, has been certified by the PSCW as being renewable energy and meeting the requirements of Acts 204 and 9. The energy costs associated with these purchases for 2006 are shown in Exhibit A-14 (PDS-2). The energy (MWh) and cost of these contracts are reflected in Mr. Lorden's exhibits for the 2006 forecast. (3 Tr 152-153)

> In its November 21, 2006 Order, page 5 the Commission found [these contracts] reasonable and prudent and approved the PSCR factor which included these renewable costs. The cost of these and other renewables has been included in each subsequent PSCR forecast, plan and reconciliation.

WEPCo entered into two renewable/surplus purchase power contracts, with COGS customers, that were not included in the 2008 PSCR plan; an extension of a contract with Waste Management's Pheasant Run Landfill and a new contract for renewable energy credits from North American Hydro. Tr 2, p 99.

As shown at Tr 2, p 97, the amount of Renewable/Surplus energy purchased, its average cost, and the average cost of MISO energy for 2006 through 2009 is:

Year	Case No.	Renewable/Surplus MWh	Renewable/Surplus $/MWh	MISO Energy $/Mwh
2006	U-14707-R	209,869	$70.89	$46.83
2007	U-15007-R	161,161	$98.03	$77.22
2008	U-15404-R	230,651	$80.25	$45.30
2009	U-15664-R	202,806	$85.68	$33.88

The above table reveals that, in 2009, WEPCo purchased less renewable/surplus energy than it did in 2008. As it does with all sources of energy, WEPCo allocated the "total system-wide renewable energy . . . across the three jurisdictions [it] serves." Tr 2, p 98. Therefore, approximately, 84% is counted toward meeting the Wisconsin RPS requirements, while 8.07736% is allocated to Michigan. Tr 2, p 98, 100. Not all of the renewable energy purchases in 2009 were used to meet the 2009 RPS. Some renewable credits will be combined with future renewable generation and purchases to meet both Michigan's and Wisconsin's RPS requirements. Tr 2, p 99.

Charges for Coal Not Taken

To explain the charges for coal not taken, WEPCo presented the following evidence. At Tr 2, p 69, Mr. Larden testified as follows:

> Q. Did the Company experience any problems with excess coal inventory during the year?
> A. Yes. Due to the downturn in the economy, the Company experienced a decrease in net output (MWh) of 9.9% which resulted in excess coal under contract at its Presque Isle and Valley power plants. The Company took steps to reduce its excess coal under contract by buying additional storage and negotiating quantity reductions. Additionally, to meet the Company's remaining coal contract commitments in the most economic manner the Company increased the burns at these plants. This was accomplished by decreasing the offer price in the MISO energy market.

At Tr 2, p 76, Mr. Larden added:

> Q. Did the Company incur any penalties, which were included in the power supply costs for this reconciliation period?
> A. The Company incurred charges for coal not taken amounting to $239,270 at its Presque Isle and Pleasant Prairie power plants. These charges were deemed to be an economical action due to the amount of excess coal inventory at these plants.
> Q. Does the calculation of power supply costs include any demurrage charges?
> A. No. Power supply costs were reduced to eliminate demurrage costs of $52,910 that were incurred during 2009 under the terms of a rail contract for the Pleasant Prairie power plant.

Also, in evidence was the Mines' Exhibit MIN-13; a copy of a discovery request answer from Bruce Browne. In it, the following was stated:

> TMS-7-4: In T Lorden's testimony. Page 20, lines 15 through 21, penalty charges incurred are discussed. The following questions pertain to this charge. Please provide more descriptive documentation as to why this excess coal inventory occurred.
> Response: A total of $139,270 in charges for Presque Isle was incurred as a result of not meeting contractual minimums for Colorado coal per the terms of one of our dock service agreements. The Colorado bituminous coal was not needed for generation due to the drop in load demand with the economic

> slowdown, and despite contracting for more storage space there was insufficient storage capacity available to take delivery of all the coal under contract. Coal supply contracted quantities were reduced and the $1.75/ton shortfall payment was incurred, per the terms of the dock services contract, as it was more cost effective than adjusting generation market offers to further increase generation. The invoice is attached. Upon further review, it was determined that $100,000 associated with constructive placement charges for Pleasant Prairie were, in fact, demurrage charges and should be excluded from PSCR costs. The invoice is attached in the amount of $99,311.20.

The remainder of exhibit MIN-13 includes copies of the invoices for the coal not taken charge and for the demurrage charge. The invoice for coal not taken indicates an amount due of $140,233.96 and appears to have Bruce Browne's signature.

In rebuttal, WEPCo's Mr. Knitter added, at Tr 2, 121-22:

> Q. In direct testimony, Mr. Gorman (page 17) and Dr. Loube (pages 5-6) challenge the recovery of $139,270 in Presque Isle ("PI") coal contract take-or-pay charges. How do you respond?
> A. Coal contract transportation quantities, including contractual dock minimum volume requirements, negotiated in 2005 for Presque Isle ("PI") were reasonable based on expected 2009 PI generation. Actual generation of 2,621,082 MWh was much lower in 2009 due to the economic recession, subsequent reductions in electricity demand, and the reserve shut-down of PI Units 3 and 4 in April, 2009 and their retirement in Ocober [*sic*] 2009. Faced with greater dock minimum volume requirements than needed at PI, the Company used all options available to minimize costs including increasing on-site inventory, buying additional storage space, reducing prices at which coal units were offered into the MISO market to increase coal burns and incurring liquidated damages for failing to meet dock minimum volume requirements. The Company chose the combination of methods designed to minimize costs.
> Q. Was the 2005 decision to enter into the coal agreement with dock minimum volume provisions reasonable and prudent?
> A. Dock minimum volume provisions are part of the negotiated items in such agreement. . . . [T]he reasonableness of the contract must be evaluated looking at the benefits and burdens of the agreement as a whole. Based upon the circumstances that existed in 2005 at the time the contract was entered into, the decision to

> enter into the agreement with dock minimum volume provisions was reasonable and prudent.
> Q. Were the actions of the Company to address its obligations under the coal transportation agreement in light of reductions in generation at PI reasonable and prudent?
> A. Yes. The decisions made and actions taken were designed to minimize costs and were reasonable and prudent.

From the evidence presented, I find that WEPCo incurred charges for coal not taken in the amount of $140,233.96 because it entered into contractual obligations to purchase more coal than it could use. The terms of the contract obligations were not disclosed in this proceeding. WEPCo burned less coal than it contracted for because, in part, economic conditions in 2009 reduced the general demand for electricity and, in part, because of WEPCo's decisions to shutdown Presque Isle Units 3 and 4, in April 2009, and to retire Units 3 and 4, in October 2009. Both Mr. Browne and Mr. Knitter testify that WEPCo contracted for additional storage space in order to reduce these charges. This is accepted as fact.

Pursuant to the testimony of the Mine's witness, Mr. Gorman, removal of the charges for coal not taken reduces Michigan PSCR costs by $11,493. Tr 2, p 150.

For a variety of reasons, I can not accept any of WEPCo's remaining assertions. First, on this issue, Mr. Larden's testimony has credibility problems. Mr. Larden testified that WEPCo incurred charges, for coal not taken, in the amount of $239,270. However, this figure is incorrect and contains nearly $100,000 in demurrage charges that are statutorily disallowed[3]. No explanation

[3] This also made false his assertion that no demurrage charges were included in the calculation of power supply costs.

was provided to explain why or how Mr. Larden included $100,000 of disallowed charges in a category of allowable charges. Furthermore, of the three witnesses to provide evidence on this matter, Mr. Larden is the only one to make mention of excess coal at WEPCo's Valley and Pleasant Prairie power plants.[4] His testimony is also unique in its reference to "negotiating quantity reductions"[5]. Furthermore, after stating that the economic downturn was the cause of the charges, he fails to mention the closure of two units. Finally, on the unrelated OC6 outage, he provided testimony that appears misleading. See fn 6, below. For these reasons, I find Mr. Larden's credibility drawn into question and find it difficult to rely upon his testimony for factual determinations.

Other than contracting of additional storage space, it is difficult to determine what actions WEPCo took to avoid these charges. Mr. Knitter states that WEPCo increased its on-site inventory. Without further explanation, I take this to mean nothing more than WEPCo used its available storage space. Mr. Knitter also states that WEPCo "reduc[ed] prices at which coal units were offered into the MISO market to increase coal burns". However, Mr. Browne states that WEPCo incurred the charges because "it was more cost effective than adjusting generation market offers to further increase generation." Without more

[4] At Tr 2, p 69, Mr. Larden makes reference to "excess coal under contract at [the] Presque Isle and Valley power plants. At Tr 2, p 76, he states that WEPCo "incurred charges for coal not taken . . . at [the] Presgue Isle and Pleasant Prairie power plants." No explanation is provided to explain his reference to the Valley power plant, in one instance, and to the Pleasant Prairie power plant, in the next.

[5] Mr. Browne does indicate that "contracted quantities were reduced and the $1.75/ton shortfall payment was incurred, per the terms of the dock services contract". I consider "negotiating quantity reductions" to be different from reducing quantities and paying a penalty, pursuant to the terms of the existing contract.

explanation, these two statements, while not necessarily incompatible, appear contradictory and make any related findings speculative.

There are also a number of important questions that WEPCo leaves unanswered. Mr. Knitter places blame for a portion of the charges on the closing of Presque Isle Units 3 and 4. However, he provides no explanation for the reasons and/or the planning of the closures. Additionally, Mr. Knitter points out that, to determine the reasonableness of a contract, one must evaluate the benefits and burdens of the agreement as a whole. However, he then provides no evidence from which to make such a determination, not even copies of the contract or contracts in question, and merely states that the decision to accept dock minimum volume provisions was reasonable and prudent. Mr. Knitter's mere conclusory claims of reasonableness and prudence do not make it so.

In short, WEPCo's evidentiary presentation suffers from credibility issues, is vague, appears contradictory, and leaves unanswered as many, if not more, questions, than it answers. As a result, factual determinations are difficult to make without resort to speculation.

Oak Creek Outage

In 2009, WEPCO's Oak Creek Unit 6 (OC6) was scheduled for an "eight-week outage[6] to address, among other maintenance, a turbine overhaul, end-of-life boiler tube material failure, replacement of superheat division walls,

[6] In his pre-filed direct testimony, WEPCo's witness, Mr. Lorden, testified that the "Oak Creek Unit 6 had a planned outage of 130 days". While it appears true that the outage lasted approximately 130 days, it was originally scheduled for only eight weeks and lasted 130 days only because of an unexpected ten week delay. I find Mr. Lorden's testimony to be misleading and, in combination with other of his factually incorrect statements, it undermines his credibility as a witness.

and investigation and correction of steam turbine inlet valve issues." Tr 2, p 123. In 2007, as part of the OC6 steam chest replacement, the steam turbine inlet valves were replaced. Tr 2, p 123. "The valve stem material was installed without incident and . . . within physical dimensional tolerance[s]". Tr 2, p 124. However, since that time, WEPCo had experienced problems with the inlet valves and it was determined that inspections of certain valves would be conducted as part of the 2009 shutdown. Tr 2, p 123. After inspecting some of the valves, WEPCo determined that it was necessary to inspect the remainder. Tr 2, p 124. After lengthy investigation into various possible causes for the valve problems, it was determined that the cause was "the valve stem manufacturing process, specifically, the lack of nitriding to increase the surface hardness of the valve stem." Tr 2, p 124. The test required to discover this flaw was a destructive test. "The only way to ensure that components such as these have been manufactured using the appropriate processes is to conduct tests at strategic intervals in the sub-contractor's off-site manufacturing processes. Tr 2, p 125.

WEPCo "concluded that the valves removed were not fit for continued service and that it would not be prudent to operate with replacement parts of the same design." Tr 2, p 124. As a result, new inlet and stop valves had to be fabricated and, along with steam chest problems discussed below, added an additional 10 weeks to the outage. Tr 2, p 124.

Exhibit MIN-7 provides 95 pages of WEPCo internal communications and other documents addressing valve related activities undertaken during the OC6

outage. Exhibit MIN-7 also sheds light on problems that WEPCo has with its OC6 steam chest castings. The record reveals that Atlas Foundry manufactured the five castings that are welded together to make the steam chest. See MIN-7, p 22. After casting, Atlas sent the inlet valve manifolds to a subcontractor for heat treating. At some point it was determined that this subcontractor, "has had some issues with improper cool down methods." Exh MIN-7, p 22. "The improper cool down causes incorrect microstructures to form which affects the material properties." Exh MIN-7, p 22. It appears that flawed heat treating caused the steam chest to crack. Exh Min-7, p 45, 61. By February 26, 2009, delays caused by these steam chest problems became a greater concern than those posed by the valves. Exh Min-7, p 27.

From Exhibit MIN-7, it appears that WEPCo acted diligently, reasonably, and with prudence to discover the metallurgical flaws in the steam chest and valves and in undertaking corrective actions.

The parties raised questions regarding the insurance and contractual arrangements that might have limited WEPCo's exposure to increased costs resulting from outages. The evidence established that, except for the Point Beach Nuclear Plant, in 2009 and, most likely, at all times, WEPCo has not had insurance to cover unplanned generator outages. Exh MIN-9. In addition, the contract between WEPCo and Siemens did not include provisions allowing WEPCo to recover increased energy costs resulting from outages at Oak Creek Unit 6. "This is typical for . . . the electric utility industry. Siemens did assume financial responsibility for equipment repairs (parts and labor)." Exh MIN-10.

With regard to the cost of replacement power necessitated by this outage, at Tr 2, p 147-48, the Mines witness, Mr. Gorman testified that:

> As shown on Exhibit MIN-12 (MPG-12), I calculate the necessary adjustment for WEPCo's substandard Oak Creek performance to be $824,037.

In response, to Mr. Gorman's calculations, WEPCo's, Mr Knitter, states, at Tr 2, 129:

> [E]ven if there were any evidence to support a finding of imprudence or mismanagement, the calculation of the cost of replacement power is erroneous. For purposes of reconciling actual costs, an accurate calculation of such costs based upon MISO Energy Market purchases should be based upon the amount of generation actually lost each hour and the corresponding hourly MISO LMP at the generation node. The MISO hourly LMPs information is available. Indeed, Wisconsin Electric prepared and provided on discovery the information necessary to prepare such a calacultion [*sic*] for OC Unit 6. Mr. Gorman's proposed methodology is inaccurate in several respects, including that it does not consider the time of year and time of day, such generation is to be replaced or the resulting variations in MISO LMPs. Given that such historical information is available (and was provided), Mr. Gorman's annual average cost methodology for calculating replacement power costs should be rejected.

Based on confidential data, CARE's witness, Dr. Loube, calculated the hourly outage replacement costs and monthly totals for the time period of the OC6 outage. See Conf Exh CARE-8. Exh CARE-3. Dr. Loube estimates that the total cost of replacement power necessitated by this outage equals $3,994,252. Exh CARE-3. Tr 2, p 184.

Natural Gas Purchases

The Mines challenge certain natural gas purchases made during mid-July to October 2008. This matter necessarily involves WEPCo's Integrated Risk

Management Plan (RMP) that sets policy for natural gas purchasing. Pursuant to the testimony of WEPCo's witness, Mr. Lorden, the Public Service Commission of Wisconsin approved the applicable RMP on December 28, 2008. Tr 2, p 62. Under the Wisconsin Administrative Code, "utilities in Wisconsin are authorized to include the costs of fuel price risk management hedging tools in their fuel costs". Tr 2, p 62. The purpose of the RMP is to "mitigate and protect against natural gas price volatility." Tr 2, p 62. In this reconciliation proceeding, WEPCo has included $3,253,724 in gas risk management transaction costs and an additional $47.1 million in gas risk management costs; the result of its hedging practices, during a period of falling natural gas prices. Tr 2, p 64, 68. Exhibit A-2 is a copy of the "Wisconsin Electric Power Company Risk Management Plan for Gas-Fired Generation" that was in effect at the time of the disputed natural gas purchases of July to October, 2008.

It reads, in part:

[redacted]

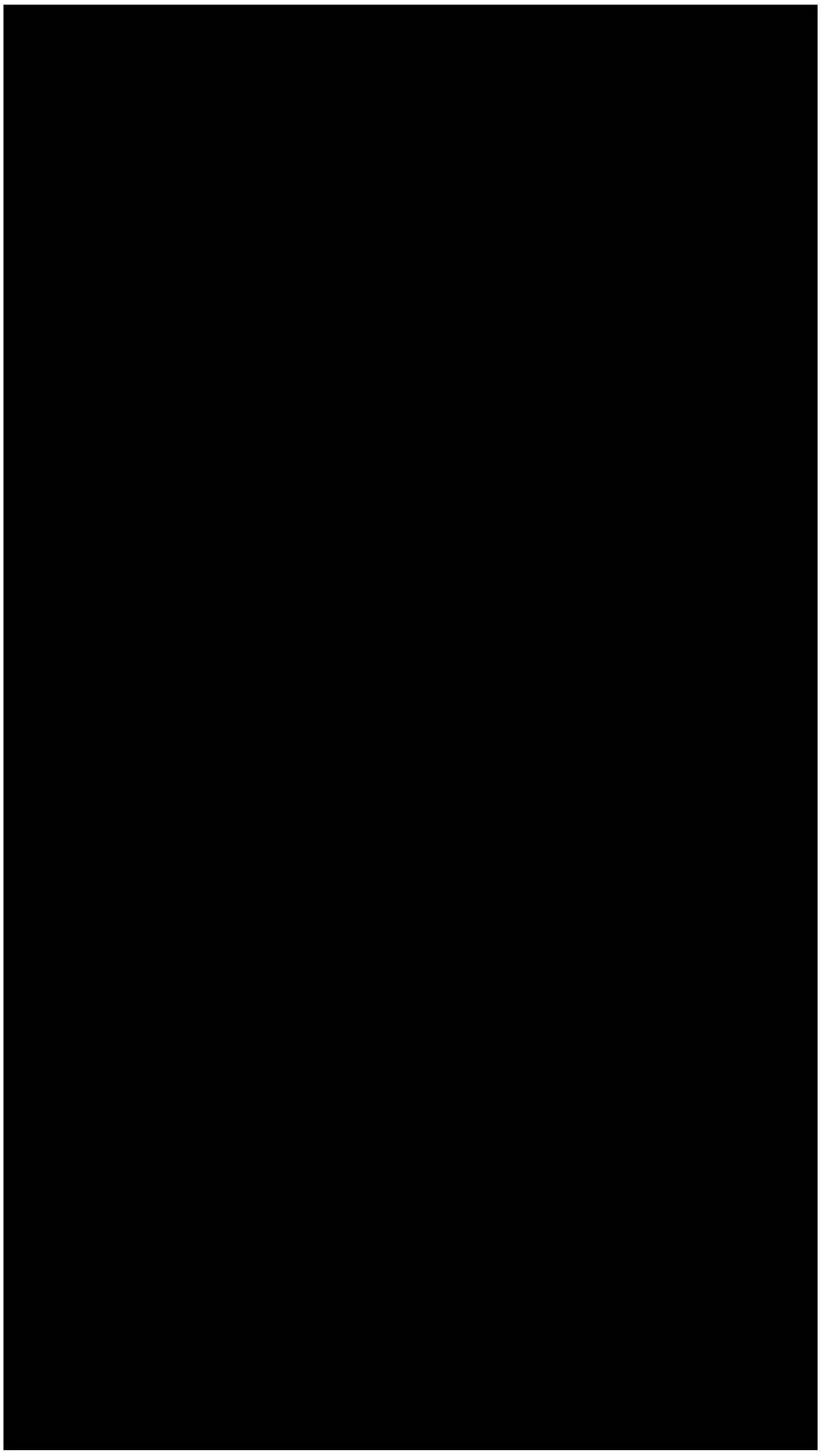
* * *

[redacted]

[redacted]

* * *

[redacted]



[redacted]

* * *

[redacted]

Confidential Exhibit MIN-18 [redacted]

[redacted] Conf Tr 2, p 240. [redacted]

[redacted]

[redacted]

[redacted] Conf Tr 2, p 240. As an example of the magnitude of WEPCo's purchases, the Mines' witness. Mr. Gorman, shows that [redacted] Conf Tr 2, p 240. [redacted] Conf Tr 2, p 241. However, in July to October, 2008, as stated by Mr. Gorman, WEPCo [redacted] and, as a result, [redacted] Conf Tr 2, p 240-41.

At Conf Tr 2, p 241, Mr. Gorman establishes that:

[redacted]

While not disclosed in its direct presentation, but, rather, admitted during discovery, WEPCo acknowledges that it entered into ten natural gas futures contracts [redacted] in violation of the RMP. Conf Tr 2, p 207, 242. Conf

Exh MIN-21. "WEPCo included the costs of these contracts in its total PSCR cost recovery calculation". Tr 2, p 155. In his rebuttal testimony, at Conf Tr 2, p 207-08, Mr. Knitter states that:

> [WEPCo] transacted ten natural gas futures contracts [redacted] These ten transactions happened in one trading day and constituted one Risk Management Violation, which was reported to the PSCW consistent with the RMP requirements. This was the only Risk Management Violation related to 2009 hedging activities and was found to be inadvertent and immaterial.

Addressing the ten future contracts that WEPCo admits violated its approved purchasing strategy, Mr. Gorman states, at Conf Tr 2, p 243, that:

[redacted]

Mr. Knitter disputes Mr. Gorman's calculations about the monetary effect of the violations and argues that the actual cost was [redacted] Conf Tr 2, p 208. Neither figure is adopted.

As evidenced by Conf Exh MIN-21 and Exh A-2, it appears that, in addition to the RMP, WEPCo's purchases are regulated through the use of internally approved trading strategies and policies. Conf Exh MIN-21 identifies two such "trading strateg[ies]"; "HTS-125" and "HTS-127". WEPCo provided no explanation of or details about trading strategies that applied during July – October timeframe.

POSITIONS OF THE PARTIES

Introduction

In its Application WEPCo claims a net under-recovery, including interest, of $1,572,080. To this, WEPCo adds $431,108 as the under-recovery, with interest, from 2008. Totaled, WEPCo claims an under-recovery of $2,003,188 to be reconciled, in this case. WEPCo is, also, asking for Commission approval to refund, in this proceeding, the $66,176 balance remaining in its Point Beach Fund from Case No. U-15220.

Staff supports approval of the Application after adjustment to disallow $100,000 for demurrage charges and addition of $66,176 for the Point Beach refund. Staff Init Br, p 3-4.

CARE recommends four disallowances to WEPCo's claimed costs: $100,000 for demurrage, $139,270 for the cost of coal not taken, $10,505,710 for certain renewable energy related costs, and $3,994,252 for fuel replacement associated with the Oak Creek outage. CARE Init Br, p 2, 13. Based on these adjustments "it is CARE's position that . . . the Commission should reduce WEPCo's 2009 under recovery to $441,950, and increase the interest for the 2009 plan year from $40,954 to $58,473. CARE Init Br, p 3.

The Mines argue that, "once proper adjustments are made", WEPCO's reported under-recovery of $1.572 million is actually a $1.504 million surplus. Mines Init Br, p 6. The Mines argue for adjustments related to "Wisconsin renewable energy costs, Oak Creek replacement power costs, coal demurrage

charges, coal penalty charges, and natural gas risk management costs." Mines Init Br, p 6.

Demurrage

WEPCo acknowledges the inclusion of $99,311 in demurrage charges that should be excluded. WEPCo Init Br, p 8. Staff, CARE, and the Mines all place this figure at $100,000. Staff Init Br, p 3. CARE Init Br, p 3-4. Mines Init Br, p 28.

With regard to Michigan's portion of this disallowance, WEPCO calculates that the proper adjustment reduces PSCR costs by $11,610. WEPCo Init Br, p 8. In its initial brief, the Mines argued that, as shown in Exhibit MIN-14, exclusion of the demurrage charges "reduces WEPCo's claimed 2009 Michigan related PSCR under-recovery by $8,252". Mines Init Br, p 29. Staff appears to suggest a disallowance of $25,544, but does not explain the manner of calculation. Staff Init Br, p 3. CARE did not clearly identify the Michigan adjustment to be made. After examining the figures presented by WEPCo, the Mines recommend adoption of WEPCo's methodology, which, after correction for a calculation error, results in a Michigan disallowance equaling $9,417. Mines Rep Br, p 3.

Renewable and Surplus Energy Purchases

WEPCo argues that "[c]onsistent with prior PSCR plans and reconciliations and its approved 2009 PSCR plan, [WEPCo] included in this 2009

PSCR Reconciliation the energy and costs of renewable energy in the determination of system-average PSCR costs." WEPCo Init Br, p 8-9.

WEPCo continues by arguing, at WEPCo Init Br, p 11-15:

> Consistent with every prior PSCR plan and reconciliation, [WEPCo] calculated Michigan PSCR costs by determining average PSCR costs on a system-wide basis, and applying that average cost to Michigan retail sales. . . . The Commission has repeatedly affirmed the appropriateness of using the system-wide average cost methodology, even in the face of challenges that certain energy from Wisconsin was not needed to meet Michigan load requirements and therefore the cost of same should be excluded.
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> In every PSCR plan and reconciliation case since at least 2001, . . . the Commission has included the energy and costs of renewable and surplus energy in determining the system-wide average for purposes of the PSCR plan, PSCR 5-year forecast and PSCR reconciliation. . . . [T]he cost of renewable energy was included without regards to the fact that no Michigan law or Commission order required an electric utility to purchase or generate any renewable energy or renewable energy credits.
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> * * *
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> In prior PSCR proceedings (e.g. Case No. U-15007), the Commission has already determined that these decisions to enter into the contracts for the purchase of such energy were reasonable and prudent and that the costs thereof should be recovered.

However, CARE argues that "because WEPCo paid a significant amount more for its renewable energy than what it could have paid in the MISO market, . . . these excessive costs were not reasonable and prudent." CARE Rep Br, p 7. WEPCo, counters by noting that, historically, the Commission has approved cost recovery for renewable/surplus energy when its price significantly exceeded MISO prices. WEPCo Init Br, p 15. CARE continues by arguing, at CARE Rep Br, p 7, that:

> [WEPCo's] simple response was that for the past four years, the average cost of renewable energy that WEPCo pays has been greater

> than the average cost of MISO energy. [WEPCo] didn't attempt to explain why [it] pays more, what the benefits and burdens are for paying more, or what the differences are between the energy they purchase, and the energy on the MISO market. . . . Therefore, it is not proper for WEPCo to recover the full amount of renewable energy costs.

Next, CARE argues WEPCo should not be allowed to recover charges associated with the renewable energy requirements imposed by the Wisconsin Renewable Portfolio Standard, by stating, at CARE Init Br, p 7-8:

> In MPSC Case No. U-15981, the Commission ruled that Michigan customers of WEPCo should not be required to pay for costs associated with the Wisconsin RPS requirements, and the Commission reduced WEPCo's Michigan costs by $4.011 million. . . .
>
> In this case, WEPCo . . . should not recover the unreasonable and excessive charges associated with renewable energy requirements imposed on WEPCo to meet the Wisconsin RPS. Based on the Commission's decision in U-15981, it is clear that the requirements a Wisconsin company has to meet to comply with Wisconsin law should have no bearing on the services it provides to its Michigan customers. If WEPCo purchases energy at costs that are excessive and substantially above Michigan alternative energy requirements for the sole purpose of fulfilling the Wisconsin RPS, those excessive costs are not reasonable and prudent, and should not be paid by Michigan ratepayers nor recovered in this reconciliation case.
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> * * *
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> Accordingly, an adjustment should be made . . . . The reasonable energy cost in this case is equal to the MWH consumed times the reasonable MISO rate of $33.88 per MWH. Therefore, the reasonable energy cost for the renewable energy is $6,871,067, and an adjustment of $10,505,710 should be subtracted from the power supply costs and net system requirements for 2009 proposed by the Company.

Similarly, after citing to the Commission's July 1, 2010, order, in Case No. U-15981, the Mines argue that the Commission has found that "production costs associated with WEPCo's compliance with the Wisconsin RPS should not be included in WEPCo's base rates in Michigan." Mines Init Br, p 11.

Therefore, the Mines argue that "costs associated with WEPCo's compliance with the Wisconsin RPS should likewise not be included in WEPCo's PSCR surcharges in Michigan." Mines Init Br, p 11.

The Mines continue their criticism by arguing that, in 2009, "WEPCo was subject to Wisconsin renewable portfolio standards ("RPS") and, "[t]o meet these standards, WEPCo purchased significant amounts of relatively expensive renewable energy." Mines Init Br, p 7. The Mines argue that "these costs are a Wisconsin regulatory policy costs and should be borne by WEPCo's Wisconsin ratepayers." Mines Init Br, p 7. For this reason, the Mines argue for finding "that WEPCo's renewable energy purchased power costs are unreasonable and imprudent and should not be borne by Michigan ratepayers." Mines Init Br, p 8. As the Mines see it, at Mines Init Br, p 10:

> Unlike Wisconsin's RPS, Michigan's . . . Public Act 295 of 2008, ensures that WEPCo's Wisconsin ratepayers will not incur the costs of . . . compliance with the Michigan RPS. Under Michigan's RPS, the incremental costs of compliance are recovered via renewable energy surcharges . . . . That portion of renewable energy costs that are comparable to what the utility would have paid for energy to meet its load is reflected in Michigan's PSCR via the "transfer price." Michigan's transfer price mechanism ensures that WEPCo's Wisconsin ratepayers will not incur the incremental costs of WEPCo's compliance with Michigan's RPS. WEPCo . . . however, imposes on Michigan ratepayers WEPCo's costs of complying with the Wisconsin RPS. Thus, Michigan ratepayers bear the entire expense of WEPCo's compliance with the Michigan RPS, and will also incur a share of the costs of WEPCo's compliance with the Wisconsin RPS under WEPCo's proposal. This is patently unjust and unreasonable.
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> Additionally, Michigan's RPS law expressly capped the level of renewable energy costs recoverable from Michigan ratepayers. Wisconsin's RPS law, however, does not . . . . If the costs of the Wisconsin RPS are allocated to Michigan ratepayers, Michigan's ratepayers will pay more to support renewable energy than the amount permitted by Public Act 295.

In response, WEPCo argues, at WEPCo Init Br, p 10:

> [N]either the language nor rationale underlying the Commission's treatment on a prospective basis of the costs of renewable energy in the July 1 Order even apply to, let alone support automatic disallowance of, the costs of renewable energy reasonably and prudently incurred in 2009. As Mr. Lorden testified:
>
> > . . . [T]he action taken in the July 1 [2010] Order was prospective only. . . . [I]t was based upon the rationale that if Wisconsin Electric were to assign the cost of a specific renewable project directly to Michigan to be recovered entirely through the Michigan Renewable Energy surcharge, then it should not continue to also assign a portion of the cost of other renewables to Michigan customers.
> >
> > However, this rationale does not apply to 2009 costs, as [WEPCo] did not . . . assign the cost of any renewable project directly to Michigan customers to be recovered in 2009 through the Renewable Energy surcharge or any other component of rates. Rather, as the Commission noted in its July 1 Order, [WEPCo's] renewable energy surcharge was not in effect at all during 2009, but first went into effect as of January 1, 2010. Thus, during all of 2009, base rates, the PSCR plan and PSCR factors all are based upon the long-standing approach of determining recoverable costs on a system-wide average basis.

WEPCo adds, at WEPCo Rep Br, p 7-8:

> [C]ontrary to the Mines' position, Act 295 expressly states that its rate limitation does not prohibit the continued recovery via base rates and PSCR proceedings of renewable energy costs. . . . The limitation in MCL 460.1045(2) on the amount of **incremental** renewable costs that can be recovered through the Michigan Renewable Energy surcharge does not apply to existing renewable costs historically recovered through rates and PSCR proceedings.

The Mines also contest the amount of renewable energy purchased, by arguing, at Mines Init Br, p 12-13, that:

> WEPCo is acquiring far more renewable energy than is necessary to comply with the Wisconsin RPS. Because renewable energy is more expensive generation than other resources

> available, WEPCo is unnecessarily incurring excess costs. WEPCo['s] decision is unreasonable and imprudent.
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> * * *
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> In 2009, WEPCo had 243,750 MWh of hydroelectric renewable energy generation, 293,769 MWh of wind renewable energy generation, and 202,806 MWh of "Renewable / Surplus" purchase power transactions. This totals 740,325 MWh of energy to satisfy a Wisconsin RPS requirement of 535,126 MWh. . . . WEPCo's decision to acquire renewable resources in excess of the statutory mandate is unreasonable.
>
> . . . [A]s shown on Exhibit MIN-3 (MPG-3), removing the excessive "Renewable / Surplus" purchased power costs from the 2009 PSCR filing, and incorporating an offsetting adjustment for lower opportunity sales reduces WEPCo's claimed 2009 Michigan related PSCR under-recovery by $921,671 and reduces the total system average PSCR cost rate by $0.413/MWh.

In response, WEPCO contends this argument is without merit and counters that is "erroneous to assume[] that the entire quantity of renewable energy obtained on a system-wide basis counts toward the Wisconsin RPS." WEPCo Init Br, p 15. [O]nly the Wisconsin allocated portion of the . . . energy is counted towards meeting the Wisconsin RPS." WEPCo Init Br, p 15-16. WEPCo points out that that the "Wisconsin allocated portion . . . of the 2009 Hydro and Wind generation is significantly less than necessary to satisfy the 2009 Wisconsin RPS requirement." WEPCo Init Br, p 16. WEPCo continues, at WEPCo Init Br, p 16, by stating:

> Like Michigan's Renewable Energy statute, under Wisconsin's RPS requirements, renewable energy credits do not expire each calendar year. MCL 460.1039(3)(c) provides that RECs may be carried forward for three (3) years. Thus, the mere fact that the amount of renewable energy obtained may exceed a calendar year's requirement does not mean that it is excessive or imprudently obtained. Indeed, Wisconsin Electric's MPSC–approved Renewable Energy Plan was built on obtaining renewables in 2009, which is a time period when there is not a requirement for obtaining any renewables.

Next, the Mines argue that, pursuant to MCL 460.6j(2), "a power supply cost recovery clause may only be used to recover certain costs and unbundled renewable energy credits [(RECs)] are not included in the enumerated costs recoverable in the PSCR clause." Mines Init Br, p 13. At Mines Init Br, p 14-17, the Mines explain that:

> The costs of unbundled [RECs] are not costs of power supply. Unbundled RECs are not fuel costs, nor are they costs of purchased and net interchanged power. When a utility purchases an unbundled REC, the utility is neither purchasing fuel nor purchasing power. Instead, the utility is purchasing a separate product that can be bought, traded or sold, independent of the power supply. The stand-alone REC may be used to demonstrate compliance with renewable portfolio standards.
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> The Commission has included the recovery of costs for certain products in the PSCR clause where such products are inextricably intertwined with fuel or purchased power costs. . . .
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> * * *
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> Unbundled RECs are not inextricably intertwined with a utility's fuel or purchased power. Indeed, RECs can be purchased on an unbundled basis, thus they are not directly connected or inextricable linked to the utility's costs of fuel or purchased power. The amount of RECs needed by a utility is not a function of fuel or purchased power, but a function of the volume of the utility's jurisdictional sales.
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> * * *
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> . . . To the extent that the Commission does not exclude all costs included in WEPCo's "Renewable / Surplus" costs, the Commission should, at a minimum, exclude $1,143,178 (on a total utility company basis) for Wisconsin RPS REC purchases.

WEPCo argues that the Mine's position with regard to RECs "is contrary to Act 304 and prior MPSC treatment of the cost of renewable energy credits . . . and without merit." WEPCo Reply Br, p 8. WEPCo argues that "the REC is an integral attribute of renewable energy"; "the attribute which changes it from

ordinary . . . energy to 'green' energy." WEPCo Rep Br, p 9. WEPCo continues by noting that "the costs of RECs . . . are 'booked' as a cost of purchased power . . . pursuant to the Uniform System of Accounts" and that "consistent with the accounting", "the RECs and renewable energy purchased pursuant to the contracts identified in Exhibit MIN-30 . . . have historically been included in, and recognized as, PSCR costs. WEPCo Rep Br, p 10. WEPCo concludes by arguing that "Act 295 does not prohibit recovery of the cost of existing RECs in the 2009 PSCR recovery process." WEPCo Rep Br, p 11.

Charges for Coal Not Taken

WEPCo acknowledges that it incurred charges of $139,270 for coal-not-taken. WEPCo Init Br, p 17. This figure is not disputed by the parties. However, the Mines and CARE argue that this charge should be disallowed. Specifically, the Mines recommend a disallowance of $11,493, as calculated in Exhibit MIN-15. Mines Init Br, p 33.

WEPCo argues that "the 2005 decision to enter onto the coal transportation contract with dock minimum volume provisions was reasonable and prudent". WEPCo Init Br, p 17. WEPCo continues by stating that, due to the economic recession in 2009, electric demand was much lower than expected and that, "'[f]aced with greater dock minimum volume requirements than needed'", WEPCo "'used all options available to minimize costs including increasing on-site inventory, buying additional storage space, reducing prices at which coal units were offered into the MISO market to increase coal burns and incurring liquidated damages for failing to meet dock minimum requirements.'"

WEPCo Init Br, p 17. WEPCo argues that its witness, Mr. Knitter, testified that these actions were reasonable and prudent and neither CARE nor the Mines "presented any evidence that the costs were unreasonable or imprudently incurred." WEPCo Init Br, p 18. "Thus", WEPCo argues, "the undisputed evidence is that these coal dock charges were reasonably and prudently incurred and should be recovered." WEPCo Init Br, p 18.

The Mines, after citing MCL 460.6j(13)(f) and MCL 460.6j(13)(h), argue that "the Commission must disallow charges for fuel not taken and penalty charges unless the costs were reasonably and prudently incurred." Mines Init Br, p 29. To support its position, the Mines look to Case No. U-12126-R where the Commission denied Upper Peninsula Power Company's request to recover costs of $35,377 for gas not taken.

WEPCo finds the Mines' reliance upon Case No. U-12126-R misplaced. WEPCo argues that, in that case, the Commission found that the utility's testimony had "credibility issues" and "the filing contained a material misstatement"; neither of which are applicable in this case. WEPCo Rep Br, p 30.

Like the Mines, CARE argues that the charge was "not explained in sufficient detail" to allow for its recovery. CARE Init Br, p 4. "WEPCo stated that the coal was not delivered because WEPCo requested the supplier to reduce the coal supply . . . due to a decrease in the demand for electricity. Therefore, the charges . . . were a penalty for not taking the necessary minimum purchase as

specified in the coal contract, in violation [of] MCL 460.6j(13)(h). CARE Init Br, p 4-5.

CARE explains, more fully, at CARE Rep Br, p 4-5, that:

> WEPCo must provide this Commission with evidence of specific actions and decisions WEPCo took that do not require the Commission to make assumptions or inferences about the reasonableness or prudence of WEPCo's practices. It is not the duty of the opposing parties to show that the charges were unreasonable and imprudent.
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> * * *
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> WEPCo is basing its assertion that its actions were reasonable and prudent upon the testimony of Mr. Knitter that "[b]ased upon the circumstances that existed in 2005 at the time the contract was entered into, the decision to enter into the agreement with dock minimum volume provisions was reasonable and prudent." However, neither Mr. Knitter nor WEPCo . . . attempted to explain exactly what those conditions were in 2005. Simply saying that it is undisputed that the costs were reasonably and prudently incurred falls well below the burden of proof WEPCo needs to establish to prove why it should be allowed to recover these costs. Because WEPCo has not met the burden of showing that these costs were reasonable and prudent, they should not be recovered in this case.

WEPCo argues, at WEPCo Rep Br, p 29-30, that:

> Contrary to CARE's assertions . . ., Mr. Knitter: (i) testified that the 2005 decision to enter into the coal contract with the minimum volumes provision was reasonable and prudent; and (ii) clearly explain the situation in 2009 that led to the incurrence of the minimum charges and the actions of Wisconsin Electric to address same in the most economical manner. (2 Tr 122) This evidence was unchallenged and unrebutted. . . . In the absence of any rebuttal evidence, this evidence satisfied Wisconsin Electric's burden of proof.

Like CARE, the Mines note that the burden of proof lies with WEPCo and argue that the "opposing parties are not obligated to introduce any evidence if WEPCo's case does not meet the evidentiary standards. The Mines continue, at Mines Rep Br, p 13-14, by stating:

> Bare assertions that the utility's management actions were reasonable and prudent are not sufficient for the utility to meet its burden.
>
> WEPCo failed to provide any evidence other than the bare assertions of its witness, Mr. Jeff Knitter. Since 2004, Mr. Knitter has worked in WEPCo's Wholesale Energy and Fuels department. Mr. Knitter does not have responsibility for any of WEPCo's generating plants, nor is there any evidence that he has any first hand knowledge of the facts and circumstances related to WEPCo's coal penalty charges. Despite the deficiencies in Mr. Knitter's qualifications, Mr. Knitter testified that WEPCo's decision in 2005 to enter into a fuel contract with minimum coal dock requirements was reasonable and prudent at the time the decision was made, and that WEPCo took actions to minimize the penalty in 2009. Mr. Knitter did not describe any of the facts or circumstances surrounding WEPCo's decision to enter into the contract, nor did Mr. Knitter provide any evidence of the steps WEPCo supposedly took to minimize the charges. Mr. Knitter's testimony is not competent, material, and substantial evidence establishing that it was reasonable and prudent for WEPCo to incur these penalty charges.

Finally, at Mines Init Br, p 31-32, the Mines argue for the higher burden of proof found under MCL 460.6j(15) and state:

> Where the utility's actions are contrary to the Commission's PSCR plan order, the utility must show by "clear and convincing evidence that the excess expenses were beyond the ability of the utility to control through reasonable and prudent actions." Where excess costs are incurred consistent with the Commission's relevant PSCR plan order, the utility must show by a preponderance of the evidence that the excess costs resulted from reasonable and prudent management actions. Because fuel penalty charges were not included in WEPCo's PSCR plan, . . . WEPCo must show by clear and convincing evidence that the fuel penalties where beyond WEPCo's ability to control through reasonable and prudent actions. Nevertheless, WEPCo does not provide even a preponderance of evidence showing that the expenses were reasonably and prudently incurred.

Oak Creek Outages

As WEPCo describes it, at WEPCo Init Br, p 20-21:

> The 2009 OC6 outage was a planned outage, originally schedule as an eight-week outage to address, among other maintenance, a turbine overhaul, end-of-life boiler tube material failure, replacement of superheat division walls, and investigation and correction of steam turbine inlet valve issues. In 2007, the OC6 steam chest, including the steam turbine inlet valves, was replaced. The OC6 unit experienced problems with the inlet valves during . . . the months following the 2007 planned outage. As part of the 2009 OC6 planned outage, inspections of certain inlet valves was conducted to determine the action to be taken to address the problems experienced. After reviewing the results of the first inspection, inspections of additional inlet valves were determined to be in order.
>
> The root cause of the problem, discovered after two months of investigation and analysis of various possible causes, was found to be the valve stem manufacturing process, specifically, the lack of nitriding to increase the surface hardness of the valve stem. . . . Wisconsin Electric concluded that the valves removed were not fit for continued service and that it would not be prudent to operate with replacement parts of the same design. Thus, prudence required that OC 6 remain out of service until new inlet and stop valves could be fabricated using the new design/process. See Exhibit MIN-7, page 16. This required an outage extension of 10 weeks.

Because the outage extended beyond 90 days, CARE argues for a disallowance of $3,994,252, pursuant to MCL 460.6j(13)(c), and states, at CARE Init Br, p 9-10:

> The manufacturer of the valve stems assumed financial responsibility for equipment repairs, however . . . WEPCo revealed it did not attempt to recover any increased energy costs from the manufacturer . . . .
>
> Additionally, . . . WEPCO should have foreseen the possibility of a valve defect and should have performed the detailed testing in 2007, not 2009. Therefore, their actions were not reasonable and prudent, and ratepayers should not be expected to pay for the Company's lack of foresight.
>
> . . . Given that the costs of such insurance are recoverable in a rate case, it is unreasonable to expect ratepayers to pay high replacement fuel costs for outages such as the one experienced at the Oak Creek Unit 6 plant.[7]

[7] To support its argument regarding insurance, CARE points to Case No. U-15676-R, Case No. U-6923, Case No. U-8291-R

Likewise, the Mines, also, criticize WEPCo for its failure to "have any plant trip insurance policy", for WEPCo's failure to "pursue remedies against [Siemens]", and for WEPCo's decision to enter a contract with Siemens that "did not provide for the recovery of increased energy costs associated with the outage". Mines Init Br, p 26.

In response, WEPCo argues that [t]here is no requirement, either in MCL 460.6j or any other statute, regulation or Commission order that an electric utility obtain replacement power cost insurance, nor any order providing for the recovery by [WEPCo] of the cost of such insurance premiums in rates." WEPCo Init Br, p 23. Further, WEPCo argues that "[i]nsurance to cover plant trips or unplanned generator outages is not cost effective, limited in availability and is very rare in the utility industry, for non-nuclear units. Utilities are much better off self-insuring for these losses rather than buying expensive insurance with high deductibles and low coverage limits." WEPCo Init Br, p 24. Finally, WEPCo argues that requiring a disallowance because the contract didn't include provisions for the recovery of placement power costs has been previously rejected by the Commission in Case No. U-10972.

The Mines continue by arguing that, pursuant to MCL 460.6j(13), "[i]n order for WEPCo to recover the replacement power costs associated with this outage, WEPCo must prove by clear and satisfactory evidence that the outage was not caused or prolonged by the utility's negligence or by unreasonable or imprudent management." Mines Init Br, p 19. The Mines add that "WEPCo did not meet this burden." Mines Init Br, p 19.

In the alternative, the Mines, argue for the applicability of MCL 460.6j(15), stating, at Mines Init Br, p 20, that:

> WEPCo . . . admitted that an increase in the volume of purchased power was a variance between its approved 2009 plan and its actual 2009 costs incurred.
>
> * * *
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> . . . WEPCo's approved PSCR plan consisted of far more steam plant generation than what was actually produced in 2009. Excessive unplanned outages caused WEPCo to purchase far more replacement purchased power costs than planned. . . . WEPCo . . . provided absolutely no explanation for why [its] steam generation fleet performed so poorly in 2009. In order to recover such excess costs, WEPCo must show by clear and convincing evidence that the excess costs incurred were beyond the ability of the utility to control through reasonable and prudent actions. WEPCo did not meet this burden.

WEPCo rejects this argument, as being contrary to the language of MCL 460.6j(15) and Commission precedent. WEPCo Rep Br, p 2-3. Rather, WEPCo argues that, pursuant to MCL 460.6j(13)(c), in order to recover its replacement power costs, it must demonstrate by clear and satisfactory evidence that the outage was not caused or prolonged by its own negligence or by unreasonable or imprudent management. WEPCo Reply Br, p 2.

The Mines continue by arguing that WEPCo's contractor, Siemens, used other than accepted practices and failed to implement standard protocol equipment changes. Mines Init Br, p 23-24. At Mines Init Br, p 25-26, they add:

> WEPCo is responsible for an act of an agent or employee within the scope of the agency or employment. . . . [I]n balancing the interests of a utility and ratepayers, public policy requires that a utility, rather than ratepayers who have no control over who the utility hires, pay for replacement power costs. . . . WEPCo cannot shift the burden of costs resulting from negligent or imprudent action merely because those actions were made by an independent contractor.

As a related argument, the Mines also argue that "WEPCo . . . did not properly supervise the manufacture of this critical generator component by a manufacturer with known problems of using improper cool down methods. Mines Rep Br, p 16.

In response, WEPCo argues, in part, at WEPCo Rep Br, p 17, that:

> [T]he root cause for the replacement of the stop valves . . . was not a utility's failure to supervise its employee or on-site contractors. Rather, the cause . . . was determined to be metallurgical conditions resulting from the manufacturing process, . . . discoverable only after extensive investigations and testing, including destructive testing. In this regard, the Commission's decision in Re Consumer Energy Co, June 3, 2010 Order in Case No. U-15415-R is instructive.

WEPCO adds that the extension of the planned outage "was due to the extensive time and effort required to [assess] the cause of the condition so that appropriate repairs could be made and future outages avoided"[8] WEPCo Rep Br, p 18. WEPCo adds that the parties have not identified anything that WEPCo could have reasonably done to avoid or shorten the outage. WEPCo Rep Br, p 19.

At Mines Init Br, p 27-28, the Mines explain their calculation of the disallowance they recommend, by stating:

> Mr. Gorman calculated the total 2009 PSCR impact associated with Oak Creek's overall lower than planned generation levels. Exhibit MIN-12 (MPG-12) applies the Oak Creek generation levels from WEPCo's plan case of 5,390,343 MWh to the actual 2009 PSCR cost calculation. Offsetting this adjustment is the reduced level of Midwest Independent Transmission System Operator ("MISO") Energy Market purchases. The net difference between the higher Oak Creek generation levels and the lower MISO Energy Market purchased power totals, reduces the total Company average PSCR rate by $0.369/MWh. On a total

[8] For WEPCo's description of the actions it undertook, See WEPCo Rep Br, p 19-23.

> Michigan basis, this adjustment reduces WEPCo's claimed 2009 Michigan related PSCR under-recovery by $824,037. The Commission should adopt Mr. Gorman's recommended adjustment.

Natural Gas Purchase

The Mines challenge the costs associated with gas hedging activities that WEPCo engaged in during mid-July to the beginning of October, 2008. The Mines allege, at Mines Init Br, p 33-34, that:

> WEPCo deviated from the principles of its approved hedging policy during several months of 2008 while hedging natural gas fuel costs for 2009. WEPCo's unreasonable and imprudent conduct resulted in increased power supply costs in 2009 that should be disallowed. Furthermore, WEPCo admitted that one of its traders conducted ten hedging contracts in violation of its approved hedging policy. . . . These ten transactions likewise increased WEPCo's 2009 fuel costs. These transactions were unreasonable and imprudent and the resulting costs should not be included in WEPCo's 2009 PSCR costs.

WEPCO takes the position that "the challenged purchases were consistent with the RMP, were reasonable and prudent and the costs thereof should be recovered." WEPCo Init Br, p 26.

WEPCo states that its RMP was approved by the Public Service Commission of Wisconsin and was designed to "mitigate and protect against natural gas price volatility." WEPCo Init Br, p 26-27. WEPCo compares the cost of its RMP to "an insurance premium against price spikes." WEPCo Init Br, p 26.

However, at WEPCo Init Br, p 35-36 (citations omitted), WEPCo states:

> With regards to [the ten challenged transactions]:
> . . . These ten transactions happened in one trading day and constituted one Risk Management Violation . . . . This was the only Risk Management Violation related to 2009 hedging activities and was found to be inadvertent and immaterial. . . .

> Furthermore, . . . [the Mines'] quantification of the impact of these transactions is erroneous. If the Commission decides to make any adjustment on this basis it should be limited to a reduction of total system-wide PSCR costs by $6,280.

The Mines reply, by arguing, at Mines Rep Br, p 23-24, that:

> The fact remains that only reasonably and prudently incurred costs are recoverable in WEPCo's Michigan PSCR factor. There is no exception to this standard for WEPCo's claim of materiality. Moreover, the total costs of WEPCo's violations were not immaterial. The total costs exceeded $500,000 on a total utility company basis.[9] That is a substantial amount of money at issue. . . . Removing the costs of these unreasonably and imprudently incurred hedge transactions reduces WEPCo's claimed 2009 Michigan related PSCR under-recovery by $38,446.

The Mines present alternative arguments for disallowance of certain fuel costs associated with hedging activities. First, the Mines argue, WEPCo's hedging activities from July to October, 2008, were unreasonable and imprudent because WEPCo "did not employ a dollar cost averaging approach consistent with its [RMP] for 2009." Mines Init Br, p 34-35.

WEPCo responds that the Mines' "description and discussion of [the RMP's] components . . . is so incomplete and inaccurate as to be artfully misleading." WEPCo Rep Br, p 26.

In response to the rebuttal testimony presented by WEPCo's witness, Mr. Knitter, the Mines argue, at Mines Init Br, p 37-38, that:

> Mr. Knitter testified as to why WEPCo accelerated its hedging purchases in July – October, 2008. Mr. Knitter's testimony is without merit. Mr. Knitter testified as to why WEPCo's natural gas traders chose to accelerate their purchases. Mr. Knitter, however, was not a natural gas trader at the time, nor was Mr. Knitter responsible [for] WEPCo's hedging activities. Mr. Knitter simply is not qualified to explain why WEPCo's natural gas traders performed the transactions that they did. Mr. Knitter's testimony is

[9] See, Confidential Exhibit MIN-22.

legally insufficient to establish why WEPCo accelerated it purchases during the relevant timeframe.

At Mines Rep Br, p 19-20, the Mines add that:

> The Commission's decisions in this proceeding must be based on competent, material, and substantial evidence. WEPCo's testimony and exhibits that purport to explain why WEPCo accelerated its purchase of hedge contracts in July – October 2008 is not competent, material, and substantial evidence. Mr. Knitter's testimony lacked an adequate foundation. Mr. Knitter was not responsible in any way for WEPCo's hedge transactions during the relevant time. Mr. Knitter did not perform any of the hedge transactions, nor did he supervise any of the personnel who performed the transactions. Mr. Knitter was simply not qualified to explain the facts and circumstances considered by WEPCo's natural gas traders that led to the acceleration of hedge contract purchases during July – October 2008. Mr. Knitter, however, was the only witness WEPCo presented to attempt to explain WEPCo's hedging activities.

The Mines continue, at Mines Rep Br, p 20-21, that:

> In contrast, . . . Mr. Gorman examined WEPCo's hedging transactions and observed an extraordinary acceleration of hedge purchases during a very short window of time from July – October 2008. Mr. Gorman further observed that WEPCo's hedging activities for its 2009 fuel purchasing were dramatically different than WEPCo's hedging activities for WEPCo's 2008 fuel purchasing. Mr. Gorman further explained that hedging such a large volume of natural gas in such a short period of time was not consistent with a systematic dollar-cost averaging approach. Instead, WEPCo's conduct was indicative of an emotional response to declining natural gas prices observed at the time. Contrary to WEPCo's assertions, Mr. Gorman's testimony was not based solely on the idea that WEPCo's conduct violated WEPCo's Wisconsin-approved risk management plan.
>
> In an effort to explain WEPCo's conduct, WEPCo's witness, Mr. Knitter, stated that WEPCo "recognized value in the market as compared to historical prices and was trying to capture lower prices". . . .
>
> . . . Simply stated, WEPCo was speculating on the market. Speculating on market prices violated the basic philosophy of WEPCo's approved risk management plan. All of these facts demonstrate the unreasonableness and imprudence of WEPCo's conduct in July – October 2008.

In Confidential Exhibit MIN-20, the Mines calculate the cost of WEPCo's actual natural gas purchases versus purchases that could have been made utilizing a long term dollar cost averaging approach to be equal to $15.947 million. See Mines Init Br, p 36, 44-45. In the alternative, the Mines argue for the disallowance of the ten natural gas futures contracts that WEPCo admits violated its RMP and argue this disallowance equals $38,446 for Michigan ratepayers. Mines Init Br, p 40-42.

DISCUSSION

Demurrage

The parties agree that either $99,311 or $100,000 in demurrage charges should be disallowed. Based on Exh-MIN-13, I have adopted the $99,311 figure. The proper Michigan allocation is less clear. CARE has not provided a Michigan allocation and Staff's calculations are unclear. The Mines have adopted WEPCo's methodology and, having corrected for a computational error, calculated the Michigan allocation to be $9,417.

Renewable and Surplus Energy Purchases

The intervenors present a number of arguments to disallow all or a portion of the renewable/surplus energy. CARE argues that it is unreasonable for WEPCo to purchase energy at costs that are excessive and substantially above Michigan alternative energy requirements for the sole purpose of complying with its Wisconsin RPS. For CARE, reasonable energy costs are equal to the

average MISO rate of $33.88 per MWh. The Mines' arguments center around the fact that Wisconsin regulators instituted Wisconsin specific renewable portfolio standards. For the Mines, costs incurred to comply with Wisconsin regulatory policy should not be borne by Michigan rate payers. Additionally, the Mines argue that WEPCo acquired more renewable energy than necessary and that doing so was unreasonable. The Mines add that P.A. 295 caps the recoverable costs of complying with renewable energy standards at a level substantially less than the cost incurred to meet the Wisconsin standards. I find none of these arguments convincing.

As indicated in the record, in 2009 WEPCo was required to meet 2.27%, or 535,126 MWh of its Wisconsin retail sales with renewable energy. To do so, WEPCo relied upon 243,750 MWh of hydro generation, 293,769 MWh of wind generation, and 202,806, of renewable/surplus purchase power transactions. As explained at Tr 2, p 94-97, much of the renewable/surplus energy was produced by COGS and purchased pursuant to Commission approved tariffs. Purchases of additional renewables were made pursuant to previously approved contracts. WEPCo indicates that two new COGS contracts were included in the 2009 figures; one an extension of a contract with Waste Management and the other for purchase of renewable energy credits from North American Hydro. Pursuant to long-standing Commission policy, WEPCo allocated these costs on a system-wide average basis. Renewable purchases that exceed the Wisconsin 2009 RPS will be used to meet Wisconsin's future RPS requirements and the mandates of Michigan's Act 295, which were first applied in 2010.

I view the Mines' argument regarding the various impacts and implications of Act 295 as, largely, a red herring, as WEPCo's renewable energy surcharge was first applied in 2010. The Mines, seemingly, wish to disallow costs, that had previously been determined reasonable, based on the application of Wisconsin's RPS and the, at the time, inapplicable mandates of Michigan's Act 295. I do not find this line of argument convincing. CARE's argument relating to the relative costs of renewable/surplus energy is, also, unpersuasive and is more reflective of unusually low MISO rates than of unreasonable renewable/surplus costs.

I find unpersuasive, the Mines arguments against inclusion of the costs of RECs. Rather, I agree with WEPCo that RECs are an integral attribute of renewable energy and that they are appropriately included in PSCR costs.

Based on the factual findings, I find these costs reasonable and prudent and reject arguments to the contrary. WEPCo has properly accounted for these costs and based on long-standing policy properly allocated a portion to Michigan. It appears that with the exception of two new contracts, which appear reasonable, all the contracts had been previously approved by the Commission and I find nothing to suggest they are anything but reasonable. Finally, as WEPCo argues, RECs are an integral attribute of renewable energy and their inclusion is appropriate and reasonable.

Charges for Coal Not Taken

Pursuant to MCL 460.6j(13)(f), the Commission "shall . . . [d]isallow charges unreasonably or imprudently incurred for fuel not taken." Based on the testimony presented, WEPCo's Presque Isle plant produced less power than it

otherwise would have because of the economic recession during 2009 and because of WEPCo's closure of Presque Isle Units 3 and 4. As a result, WEPCo had more coal under contract for purchase than it could use, had to curtail purchases, and incurred charges for the coal not taken.

The parties have directed attention to a number of cases to support their positions on this cost. I believe the Commission's April 16, 2002, Opinion and Order, in Case No. U-12126-R is most on point. In that case, Upper Peninsula Power Company (UPPCo) incurred charges for gas that it nominated for delivery, but did not use because of mechanical problems at a plant. The Commission disallowed recovery of these charges under the provisions of MCL 460.6j(15). In disallowing the costs, the Commission found that "UPPCo's factual presentation was incomplete and lacking in credibility" and, as filed, the application "contained a material misrepresentation of fact". *Application of Upper Peninsula Power Co*, U-12126-R, p 10 (April 16, 2002). In addition, the Commission noted that UPPCo's "testimony provides only bare assertions that . . . management actions were reasonable and prudent. *Id.*, at 11. In addition, the Commission cited UPPCo's failure to explain the problems at its plant. Finally, the Commission noted UPPCo's failure to present evidence of the reasonableness and prudence of take-or-pay provisions in its contract.

The similarities between Case No. U-12126-R and this case are numerous. First, WEPCo filed this application with factually incorrect information regarding these charges. Additionally, WEPCo provided no evidence regarding the details of the terms of the contracts that resulted in these charges. Likewise,

WEPCo provided no information regarding the details and planning of the shut down of PI Units 3 and 4. WEPCo's entire defense of these charges rests on the fact that it contracted for additional storage space and bare assertions that its actions were reasonable and prudent. In short, WEPCo's factual presentation was incomplete and lacking in credibility. Based on the record presented, I find that WEPCo has not established, by a preponderance of the evidence, that the charges for fuel not taken were reasonable and/or prudent. Pursuant to the Commission's decision in Case No. U-12126-R, these charges are disallowed under MCL 460.6(j)(15).[10]

The charges of $139,270 for coal not taken are disallowed.

Oak Creek Outages

Pursuant to MCL 460.6j(13)(c), the Commission "shall . . . [d]isallow net increased costs attributable to a generating plant outage of more than 90 days in duration unless the utility demonstrates by clear and satisfactory evidence that the outage, or any part of the outage, was not caused or prolonged by the utility's negligence or by unreasonable or imprudent management."

WEPCo's Oak Creek Unit 6 was out for 130 days. This outage began as a planned 80 day outage for regular maintenance and to investigate underperforming valves that had recently been replaced. After an extensive investigation that ultimately required destructive testing, it was discovered that

[10] Additionally, I find the charges properly disallowed pursuant to MCL 460.6(f). I start by finding that it is inherently unreasonable and imprudent to pay charges for a product that is not received and that it is unreasonable and imprudent to enter contracts for the purchase of coal to fire units that are retired. It was then WEPCo's burden to present sufficient evidence to establish the reasonableness and prudence of the charges incurred under these circumstance. WEPCo failed to carry this burden.

metallurgical flaws during manufacturing of the OC6 steam chest and associated valves were the source of the problems. As a result of the extensive investigation and repairs to both, the outage was extended and additional 10 weeks. During this time, new valves were produced and installed and cracks in the steam chest were repaired. From the record, it appears that WEPCo diligently investigated the problems and acted reasonably and prudently to, as quickly as possible, bring OC6 back on line. I find the evidentiary record clear and satisfactory in this regard.

Also clear is that WEPCo was not the manufacturer of the faulty materials. However, the interveners wish to hold WEPCo responsible for this manufacturing error. The Mines cite Commission orders in Case Nos. U-7830, U-8545, and U-15001 to support their argument that WEPCO is responsible for the acts of it agents. WEPCo , however, directs attention to Case No. U-15415-R. In Case No. U-15001-R, the Commission stated that it "has consistently found that replacement power costs incurred as a result of the negligence of the utility or the employee or agent of the utility acting within the scope of its employment or agency are not recoverable." *Application of Consumers Energy*, U-15001-R, p 8 (March 2, 2010). In that light, the Commission then disallowed costs incurred as a result of a crane accident caused by one of the utility's contractors. In relevant part, in Case No. U-15415-R the Commission allowed replacement fuel cost recovery for an extended outage by finding that the utility acted diligently in diagnosing a repairing a turbine. Application of Consumers Energy Co, U-15415-R, p 15 (June 3, 2010).

As already found above, WEPCo acted properly to diagnose and fix the problems associated with its steam chest and valves. The decision in Case No. U-15415-R supports the conclusion that a disallowance is improper in such situations. However, in cases where it is alleged that the utility is responsible for the underlying cause of the outage, rather than how the utility responded to the outage, Case No. U-15415-R is inapplicable. In this instance, Case No. U-15001-R is instructive.

In that Case, the Commission found that the negligence of a utility's contractor is imputable to the utility, itself. Therefore, in the case at bar, the question to be answered is whether WEPCo has established, by clear and satisfactory evidence, that it or its contractors, did not cause or prolong the outage by negligent acts or unreasonable or imprudent management.

With this question in mind, an examination of the evidentiary record reveals little with regard to the steam chest problems. This void in the record is certainly the result of WEPCo's decision to remain silent about the problem. Based on the Mine's exhibits, the record reveals that Atlas Foundry manufactured the five castings that were welded together to make the steam chest and sent the inlet valve manifolds to a subcontractor for heat treating. At some point, it was determined that the unidentified subcontractor used improper cool down methods that, it appears, adversely affecting the material properties and caused the steam chest to crack. It appears that WEPCo was able to fix the cracks, but not the underlying metallurgical defect. While the valves were the

initial concern for WEPCo, Exhibit MIN-7, shows that the steam chest problem soon became the greater concern and contributed to the extended the outage.

With regard to the faulty valves, at Tr 2, p 125, WEPCo admits that, "to ensure that [the valves] have been manufactured using the appropriate processes", tests could have been conducted "at strategic intervals in the . . . manufacturing processes." However, after identifying what would have prevented the faulty manufacture of the valves, WEPCo then fails to address why such tests were not conducted and, if they were, what the results revealed.

Based on this record, the Mines make a number of arguments. First, they argue that outages are attributable to "other than accepted practices", which led to localized heating and plant failure. However, the reference to evidence establishing the use of "other than accepted practices" relates to a ten day outage of Oak Creek Unit 8 and is unrelated to the OC6 outage. See MIN-7, p 3, 5. Additionally, the Mines make reference to a failure to implement standard protocol while honing valve bushings. This criticism appears misdirected. As found at MIN-7, p 55, the admission does not appear related to the cause or length of the outage, but rather to a new method for installation of the newly manufactured valves. The Mines, also, argue that WEPCo was negligent for failing to properly supervise a "manufacturer with known problems of using improper cool down methods." To support this argument, the Mines point to statements found at Exh MIN-7, p 21, 37. This argument may have merit. The record does indicate that the subcontractor who heat treated WEPCo's steam chest castings had known process problems. However, when these problems

became known is not addressed in the record. Additionally, the degree, if any, to which this subcontractor was supervised by WEPCo or any other entity is not addressed. Furthermore, I find nothing in the record to establish the qualifications of this subcontractor to perform the required work.

In sum, a review of the record and, in particular, Exh MIN-7 reveals that the steam chest and its valves on WEPCo's OC6 were manufactured using faulty processes that appear to have undermined its reliability and increased "risk". Exh MIN-7, p 34-35. It appears that this extended outage resulted in the installation of properly manufactured valves. However, while WEPCo was able to fix certain cracks in the steam chest, it appears that the steam chest problems remain for the long term. It appears clear that, during the manufacturing of these components, WEPCo and/or Seimens and its subcontractors acted negligently and/or unreasonably or imprudently managed the operations.

In order to avoid a disallowance, WEPCo must establish by clear and satisfactory evidence that the outage was not caused by its own or its contractors' negligence or unreasonable or imprudent management. WEPCo has addressed these issues, when at all, with minimal evidence. I am unable to determine, with confidence, what company improperly manufactured the faulty components, what, exactly, the process flaws were, how they could have been avoided, and who was responsible for supervising production.

Most troublesome for WEPCo's case, however, is WEPCo's admission that tests, conducted at strategic intervals of the subcontractor's manufacturing process, could have ensured proper manufacturing. As shown by Exh MIN-7,

this sounds much like the measures taken by WEPCo during the remanufacturing and repair processes undertaken during the outage. Strikingly, WEPCo does not address any such oversight during the original manufacturing process. This void in the evidentiary record, alone, forces the conclusion that WEPCo has failed to meet the clear and satisfactory standard mandated by MCL 460.6j(13)(c).

Regarding the disallowance to be made, from the record, it appears that the calculations made by CARE's witness, Dr. Loube, are the most reliable Dr. Loube calculated both the hourly outage replacement costs and monthly totals for the time period of the OC6 outage. Based on his estimates I find that the total cost of replacement power necessitated by this outage to equal $3,994,252.

Natural Gas Purchases

In his confidential, rebuttal testimony, WEPCo's witness, Mr. Knitter provided testimony to explain the Mid-July to October, 2008, purchases. He testified that, during the July-October 2008 period, WEPCo did not, in any month, hedge more than [redacted] of its projected gas supply for any month in 2009 or have hedged more than 75% of its, then, projected gas needs for any month in 2009. Conf Tr 2. p 199.

At Conf Tr 2, p 202-05 is found the following colloquy with Mr. Knitter:

> Q. Why did [WEPCo] decide to accelerate in July-October 2008 its hedging for 2009?
>
> A. For months prior to the July-October 2008 timeframe, prices for the 2009 annual strip were in the $10-13/Mcf price range. In fact, $14/Mcf was the average price for January-March

2009, as late as July 3, 2008. Shortly after July 3, 2008, a significant price break developed in which prices dropped over 20% by August . . . . As prices were dropping, [redacted] . . . . During . . . July through October, 2008, prices were below the 40 and 200-day moving average and within "the ballpark" of where prices were prior to February, 2008, when prices began to spike.

* * *

[redacted] the primary factors that drove natural gas prices to over $12 in June and July remained prevalent. Concerns about hurricane threats in the Gulf of Mexico producing region and worries about Canadian gas and LNG imports curtailments were high. Also, there were low U.S. storage inventory levels approaching the winter withdral [*sic*] season. Annual LNG imports for 2008 were projected in August to be 420 bcf, well below the previous years actual of 770 bcf. In addition, U.S. storage levels, as of July 4, 2008, were 389 bcf below 2007 storage levels at the same time.

In addition, a look back over 2001 through 2007 seasonal trends [redacted] A very strong and consistent pattern had developed over that period in which the seasonal low for gas futures occurred in August and September. The only time in which such a seasonal low did NOT occur in the prior 7 years was in 2005 following Hurricanes Katrina and Rita. These two hurricanes and the impact they had on natural gas prices were, and still are, viewed as extraordinary events. Furthermore, even in 2005, the average price of 2006 futures increased during the period of October through December, 2005. Thus, historically, the August and September time frame is typically one of the best hedging opportunities of the year. Typically after a seasonal low is set, a rally will occur for the rest of the year. In the years prior to 2008 in which a low was set in August or September, the average increase in the natural gas future prices after that had been approximately 29%. These factors were all considered [redacted]

Through September 2008, this historical pattern appeared to be reoccurring until the entire U.S. economy suddenly went through a cataclysmic downturn, starting in October, 2008 and prices on nearly every commodity market decreased unexpectedly and rapidly as a result. It is worth mentioning that the cost to purchase natural gas also decreased substantially.

The second and third paragraph of the above quote was the subject of the Mine's motion to strike. The motion was denied so as to permit Commission review of a more full record. However, it was my opinion then, as it is now, that WEPCo failed to establish the necessary foundation to properly admit this testimony.

At Tr 2, p 103-04, Mr. Knitter's professional credentials are provided. Mr. Knitter has a degree in Mechanical Engineering and has dedicated his professional career to work with WEPCo. For his first eight years, he worked as a plant engineer. From 1995 to 2000, he was WEPCo's Manager of Resource Planning, where he was responsible for generation planning. From 2000 to 2004, he was Manager – Special Projects in WEPCo's Legal Department. Since 2004, he has worked in the Wholesale Energy and Fuels Department with responsibilities related to the MISO energy market, MISO ancillary services market, financial transmission rights, and long range planning. In 2005 and 2006, he was responsible for the RMP update and approval process of a version of the RMP that is not of issue in this case. Lacking from his credentials is involvement in natural gas purchasing during the relevant timeframe.

At a most fundamental level, MRE 602, bars a witness from testifying "to a matter unless evidence is introduced sufficient to support a finding that the witness has personal knowledge of the matter." As the record shows, the challenged testimony was provided in response to a question asking **why** WEPCo decided to accelerated its hedging purchases in July-October 2008. However, before allowing the witness to answer this question, MRE 602 requires

evidence sufficient to establish that Mr. Knitter actually does have personal knowledge of why WEPCo acted as it did. A review of the record provides no evidence to suggest Mr. Knitter was in any position to know the basis for the challenged purchasing decisions. During the relevant times, Mr. Knitter had no responsibilities related to actual gas purchases and he provides no insight as to the source of his testimony; whether it's based on actual first-hand observations, hearsay, or if it's just how he thinks things should have been. Thus, because a proper foundation is absent from the record, it is not possible to determine if Mr. Knitter's testimony is based on anything more than pure speculation. Because no foundation exists for his testimony, no conclusions can be drawn from it.

The question of why the purchases were made is a simple factual inquiry into why certain persons, who, it is noteworthy to mention, remain unidentified by WEPCo, made certain purchasing decisions.[11] From these facts, one may decide whether those decisions were reasonable and prudent. However, Mr. Knitter does not claim to be one of the individuals responsible for these decisions, nor does he claim to be their superior or, for that matter, anyone in the chain of authority with responsibility for these decisions. The Mines state, "Mr Knitter seeks to submit as testimony the personal thoughts of others. Mr. Knitter lacks personal knowledge of the information contained in his testimony, and the testimony should be stricken under MRE 602." I agree.

[11] Because this is a factual inquiry into reasonably easily understood matters, I do not consider Mr. Kitter's testimony to fall under the purview of MRE 702.

None-the-less, because the Commissioners will most certainly have the final word on this matter, I admitted this testimony into evidence. As I have generally made clear when addressing admissibility issues, if error is to be made, I prefer to err on the side admission. Evidence that I consider inadmissible or untrustworthy, due to foundational flaws, may be viewed quite differently by the Commissioners. With this in mind, I denied the Mine's Motion to Strike and allowed the testimony to stand. However, I am as convinced, today, as I was then, that, for lack of proper foundation, the record does not establish that Mr. Knitter is competent to testify about why WEPCo engaged in the heavy purchase of futures contracts from mid-July to October 2008. Therefore, I give the challenged testimony no weight. Additionally, for the same reasons, I give no weight to the remainder of Mr. Knitter's testimony answering the above quoted question.[12] None-the-less, the question remains as to whether WEPCo has established that these purchases were reasonable and prudent.

[12] While this decision is based on foundational problems, Mr. Knitter's testimony has other problems that effect the proper weight to be given it. For instance, at Conf Tr 2, p 195-197, Mr. Knitter quotes at length from the RMP. However, the quotes at Conf Tr 2, p 196, ln 15-20; Conf Tr 2, p 197, ln 12-14; and Conf Tr 2, p 197, ln 14 are not consistent with the language found in the RMP, presented as Exh A-2. Further, in Exh A-2, I was unable to find reference to the [redacted] that, at Conf Tr 2, p 198, Mr. Knitter testifies [redacted] Additionally, Mr. Knitters discovery responses, provided as Exh MIN -34 through Exh MIN -41, are largely nonsensical. For instance, with the removal of extraneous verbiage, the first sentence of his answers can be read, [redacted] I do not consider this statement insightful and, with the exception of the [redacted] provided by WEPCo's [redacted] Mr. Knitter fails to identify what "information" he claims WEPCo considered in making its purchase decision. The remaining portions of his discovery responses were, similarly, lacking in clarity and insightfulness. Finally, at Conf Tr 2, p 207, Mr. Knitter claims, in his rebuttal testimony, that had WEPCo [redacted] However, the surrebuttal testimony of Mr. Gorman makes clear that this statement is false and the underlying analysis is flawed. In short, based on these considerations, other weaknesses in his testimony, and the foundational problems associated with his testimony, I find Mr. Knitter generally lacking in credibility.

Mr. Knitter asserts that "[d]uring the period [from mid-July to October, 2008], the RMP had two different restrictions related to the number[13] of hedges [WEPCo could] complete over a given amount of time, a cumulative maximum limit and a monthly limit." As noted, above, he then goes on to claim that, during this period, WEPCo, did not hedge, in any month, "more than [redacted] of its projected gas supply for any month in 2009" or "have hedged more than 75% of its then projected gas supply for any month in 2009". Countering this claim is the Mines' graphical representation of purchases found in Exhibit MIN-18. Unfortunately, because Mr. Knitter's credibility is weak and he presented no figures to back up his self-serving conclusory statement and because I find the Mines' graphical representations impossible to accurately decipher, I do not feel either party has established whether WEPCo's July to October purchases did, or did not, violate the [redacted] and 70% restrictions of the RMP.

As found above, WEPCo acknowledged in a discovery response that it entered into ten natural gas futures contracts, in violation of the RMP, and included their costs in its total PSCR cost recovery calculation. WEPCo characterized these violations as inadvertent and immaterial. As part of this disclosure, WEPCo made reference to the use of approved trading strategies, as provided for in the RMP. Other than this fleeting reference, however, WEPCo makes no mention of its approved trading strategies. None-the-less, it appears that WEPCo's trading strategies were an integral part of its purchasing process. The absence from the record of any discussion of these strategies confounds a

[13] I assume that Mr. Knitter does not mean to suggest that the number of hedge transactions was limited, but, rather, that the volume of gas hedged was limited.

determination as to the reasonableness and prudence of the mid-July to October purchases.

For a number of reasons, I can not find that WEPCo has met the burden of establishing that its mid-July to October natural gas costs was reasonably and prudently incurred. First, as noted above, vital portions of Mr. Knitter's rebuttal testimony lacks a proper foundation and is given no weight in this decision. Other portions of his testimony are conclusory in nature and completely void of verifiable and testable data. Still, other portions misquote the RMP. Like his testimony, Mr. Knitters' discovery answers provide very little insight into the issues. Further, WEPCo fails to address its approved trading strategies, under which, presumably, its purchases were made. About the only thing clear is that WEPCo made very significant changes to its natural gas purchasing patterns and fails to satisfactorily explain why/how this came to be.

I note that, had a proper record been developed, WEPCo may very well have established that these, and other, costs were prudently and reasonably incurred. However, in this case, when challenged on these costs, WEPCo responded with flawed and limited evidence to explain them. Therefore, based on the record presented, including the calculations found in Conf Exh MIN-20, I find that a disallowance of $15,946,526 is required.

CONCLUSION

For the reasons stated above, WEPCo's Application is approved with the following disallowances:

- $99,311.20 in demurrage charges;

- $139,270 for coal not taken;

- $15,946,526 for natural gas purchases;

- $3,994,252 for replacement fuel costs;

Based on the disallowances above, the complexity of the calculations involved, and ambiguities regarding whether the parties have accounted for interest, WEPCo is directed to submit a recalculation of the net over/under recovery, within 21 days of the issuance of this PFD. The remaining parties may respond to WEPCo's filing within 10 days.

Any evidence and arguments not specifically addressed in this Proposal for Decision were deemed irrelevant to the findings and conclusions of this matter.

MICHIGAN ADMINISTRATIVE HEARING SYSTEM
For the Michigan Public Service Commission

Mark Eyster

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Mark D. Eyster
Administrative Law Judge

July 8, 2011
Lansing, Michigan
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